STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
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November 1, 2002

Dear Interested Party :

Enclosed is the Status Report for the November 12, 2002 Business Taxes Committee meeting regarding proposed amendments to Regulation 1616(d), *Federal Areas, Indian Reservations*. The status report provides the background and a discussion of the "reservation-based value" issue and includes regulatory language proposed by the California Indian Gaming Association to relieve on-reservation Indian retailers from the duty to collect use tax on sales of tangible personal property having value added on the reservation. The report also includes the National Association of Convenience Stores and the Society of Independent Gasoline Marketers of America's position opposing amendments to the regulation.

Thank you for your input on these issues and I look forward to seeing you at the Business Taxes Committee meeting at 9:30 a.m. on **November 12, 2002** in Room 121 at the address shown above.

Sincerely,

Ramon J. Hirsig
Deputy Director
Sales and Use Tax Department

RJH: lk

Enclosures

cc: (all with enclosures)
Honorable John Chiang, Member, Fourth District
Honorable Johan Klehs, Member, First District
Honorable Dean Andal, Member, Second District
Honorable Claude Parrish, Member, Third District
Honorable Kathleen Connell, State Controller

Mr. John Thiella, Board Member's Office, Fourth District (MIC 72)
Mr. Steven Kamp, Board Member's Office, Fourth District (MIC 72)
Ms. Jean Alexander, Board Member's Office, First District
Mr. Arnulfo Hernandez, Board Member's Office, First District (MIC 71)
Ms. Rita Perry, Board Member's Office, First District (MIC 71)
Mr. Neil Shah, Board Member's Office, Third District
Mr. Romeo Vinzon, Board Member's Office, Third District
Mr. Matthew Zylowski, Board Member's Office, Third District
Ms. Marcy Jo Mandel, State Controller's Office
Mr. James E. Speed (MIC 73)
Mr. Timothy Boyer (MIC 83)
Ms. Janice Thurston (MIC 82)
Mr. Warren Astleford (MIC 82)
Ms. Carla Caruso (MIC 82)
Ms. Jean Ogrod (via e-mail)
Mr. Jeff Vest (via e-mail)
Mr. David Levine (MIC 85)
Mr. Steve Ryan (via e-mail)
Mr. Rey Obligacion (via e-mail)
Ms. Jennifer Willis (MIC 70)
Mr. Dan Tokutomi (via e-mail)
Mr. Dave Hayes (MIC 67)
Ms. Charlotte Paliani (MIC 92)
Mr. Joseph Young (via e-mail)
Mr. Jerry Cornelius (via e-mail)
Mr. Jeffrey L. McGuire (via e-mail)
Mr. Vic Anderson (MIC 40 and via e-mail)
Mr. Larry Bergkamp (via e-mail)
Mr. Geoffrey E. Lyle (MIC 50)
Ms. Laureen Simpson (MIC 50)
Ms. Leila Khabbaz (MIC 50)
Ms. Cecilia Watkins (MIC 50)

AGENDA — November 12, 2002 Business Taxes Committee Meeting

Proposed Regulatory Changes Regarding Sales by Indian Retailers on Reservations
Regulation 1616(d), Federal Areas, Indian Reservations

Action Item	Proposed Regulatory Language
Action 1 — Collection of use tax by Indian retailers on sales to non-Indians and Indians not residing on a reservation in California. Regulation 1616(d)(3)(A)2. Agenda, pages 2–3. Status Report Pages 3-4.	Adopt proposed amendments to provide that Indian retailers are not required to collect use tax from non-Indians for on-reservation sales of tangible personal property when expressly preempted by federal statutes, regulations or policy, or when the following conditions are met. The proposed amendments are in addition to the exceptions recently adopted by the Board for the sale of meals, food and beverages at eating and drinking establishments: • The tangible personal property is intended for use in on-reservation gaming activities, or to advertise or promote patronage of a tribal gaming facility through the display of the facility's or the tribe's name, logo or other identifying information. • The tangible personal property a) is made from raw materials produced on the reservation; b) reflects or illustrates tribal history, culture or tradition; c) is intended for use in an on-reservation activity; or d) is not generally available for purchase outside of a reservation. OR Make no changes to Regulation 1616, *Federal Areas*, as amended by the Board on October 3, 2002.
Action 2 — Authorization to Publish	Recommend the publication of amendments to Regulation 1616 as adopted in the above action. Operative Date: None Implementation: 30 days following OAL approval.

AGENDA — November 12, 2002 Business Taxes Committee Meeting

Proposed Regulatory Changes Regarding Sales by Indian Retailers on Reservations
Regulation 1616(d), Federal Areas, Indian Reservations

Action Item	Regulatory Language Adopted by the Board on October 3, 2002 – Make no change to adopted language	Proposed Amendments
Action 1 -		
Exceptions to the requirement that Indian retailers collect use tax on sales of tangible personal property to non-Indians and Indians who do not reside on a reservation.	Regulation 1616, Federal Areas. (d) Indian Reservations. (3) Sales by On-Reservation Retailers. (A) Sales by Indians. 2. Sales by Indians to non-Indians and Indians who do not reside on a reservation. Sales tax does not apply to sales of tangible personal property by Indian retailers made to non-Indians and Indians who do not reside on a reservation when the sales are negotiated at places of business located on Indian reservations if the property is delivered to the purchaser on the reservation. Except as exempted below, Indian retailers are required to collect use tax from such purchasers and must register with the Board for that purpose. Indian retailers selling meals, food or beverages at eating and drinking establishments are not required to collect use tax on the sale of meals, food or beverages that are sold for consumption on an Indian reservation.	Regulation 1616, Federal Areas. (d) Indian Reservations. (3) Sales by On-Reservation Retailers. (A) Sales by Indians. 2. Sales by Indians to non-Indians and Indians who do not reside on a reservation. Sales tax does not apply to sales of tangible personal property by Indian retailers made to non-Indians and Indians who do not reside on a reservation when the sales are negotiated at places of business located on Indian reservations if the property is delivered to the purchaser on the reservation. Except as exempted below, or as expressly preempted by federal statute, regulation or policy, Indian retailers are required to collect use tax from such purchasers and must register with the Board for that purpose-: a. Indian retailers selling meals, food or beverages at eating and drinking establishments are not required to collect use tax on the sale of meals, food or beverages that are sold for consumption on an Indian reservation-; b. Indian retailers are not required to collect use tax on the sale of tangible personal property sold on a reservation, without regard to the origin of such tangible personal property, if the tangible personal property is intended for use in on-reservation gaming activities, or to advertise or promote patronage of a tribal gaming facility through the display of the facility's or the tribe's name, logo or other identifying information;

AGENDA — November 12, 2002 Business Taxes Committee Meeting

Proposed Regulatory Changes Regarding Sales by Indian Retailers on Reservations
Regulation 1616(d), Federal Areas, Indian Reservations

Action Item	Regulatory Language Adopted by the Board on October 3, 2002 – Make no changes to adopted language	Proposed Amendments)
		c. Indian tribes/Indian retailers are not required to collect use tax on the sale of tangible personal property sold on a reservation if the property a) is made from raw materials produced on the reservation, b) reflects or illustrates tribal history, culture or tradition, c) is intended for use in an on-reservation activity, or d) is not generally available for purchase outside of a reservation.

BOARD OF EQUALIZATION
STATUS REPORT

- ☐ Board Members
- ☒ Business Taxes Committee
- ☐ Customer Services and Administrative Efficiency Committee
- ☐ Legislative Committee
- ☐ Property Tax Committee
- ☐ Other [Insert Name]

Topic:

At the September 12, 2002 discussion of Chief Counsel Matters – Rulemaking, the Board directed staff to work with interested parties and, at the next scheduled Business Taxes Committee meeting, bring forward amendments to Regulation 1616(d), *Federal Areas – Indian Reservations,* that would add exceptions to the obligation of on-reservation Indian retailers to collect use tax on the sale of tangible personal property with reservation-based value.

Background:

On March 27, 2002, the Board held a public hearing and adopted proposed amendments to Sales and Use Tax Regulation 1616. The amendments were proposed to relieve Indian retailers from the duty to collect use tax on the sale of meals, food and beverages sold at eating and drinking establishments for consumption on the reservation, and on the sale of other tangible personal property having "reservation-based value." The background, discussion, and development of this topic are included in an issue paper that staff prepared in December 2001. The issue paper is available on-line at http://www.boe.ca.gov/meetings/pdf/1616ip.pdf.

During the regulatory review process, the Office of Administrative Law (OAL) raised necessity and consistency objections to all the proposed amendments, and an objection to the portion of the amendments regarding "reservation-based value" under the clarity standard (Government Code section 11349.1). OAL stated that the proposed definitions of reservation-based value did not give adequate guidance as to the criteria for property having reservation-based value. On July 16, 2002, staff withdrew the proposed amendments to the regulation in lieu of OAL rejecting the proposed changes. On September 12, 2002, the Board, in consideration of OAL's objections regarding clarity, approved amendments related only to the meals, food and beverages sold at eating and drinking establishments for consumption on the reservation, and directed staff to begin a new regulatory process regarding reservation-based value. Following an additional public comment period, the Board adopted the amendments related to sales of meals, food and beverages on October 3, 2002. A copy of Regulation 1616(d), *Indian Reservations*, with the October 3, 2002 amendments adopted by the Board is available on-line at www.boe.ca.gov/regs/1616cont.htm. These amendments have also been incorporated in subdivision (d)(3)(A)2.a. of the regulation illustrated in Exhibit 2. Discussion of the issue of reservation-based value is scheduled for the November 12, 2002 Business Taxes Committee meeting.

The following table illustrates the dates anticipated for the adoption, review, and approval of the amendments proposed by the Board:

Proposed Amendments to Regulation 1616	Board Authorizes Publication of Proposed Amendments	Public Hearing – Board Adopts Proposed Amendments	Anticipated deadline for OAL Review	Anticipated Effective Date
Amendments regarding on-reservation sales of meals, food, and beverages sold at eating and drinking establishments		10/3/2002	12/20/2002	1/20/2003
Amendments regarding on-reservation sales of tangible personal property having value added on the reservation	11/12/2002	2/5/2003	4/15/2003	5/15/2003

A meeting with interested parties was held on September 26, 2002 to further discuss the concept of reservation-based value as it pertains to the collection of use tax by Indian retailers on Indian reservations. After the meeting, tribal representatives attending the meeting joined the California Nation Indian Gaming Association (CNIGA) in submitting the proposed regulatory language described below. The proposed regulatory language submitted by CNIGA is set forth in Exhibit 2. At the same time, staff received a letter from Collier Shannon Scott, PLLC (Collier) on behalf of the National Association of Convenience Stores (NACS) and the Society of Independent Gasoline Marketers of America (SIGMA), opposing revisions to Regulation 1616. Collier's submission is attached as Exhibit 3.

Current Status:

Submission Made by CNIGA

In addition to the revisions previously adopted by the Board regarding Indian retailers' on-reservation sales of meals, food and beverages at eating and drinking establishments for consumption on the reservation, CNIGA's recommendation, as illustrated in Exhibit 2, provides exceptions to the Indian retailer's obligation to collect and remit use tax on sales of tangible personal to non-Indians and Indians not residing on a reservation. CNIGA'S recommended amendment provides that the proposed exceptions would apply when:

1) The obligation to collect use tax is preempted by federal statute, regulation or policy.

2) The tangible personal property is intended for use in on-reservation gaming activities, or to advertise or promote patronage of a tribal gaming facility through the display of the facility's or the tribe's name, logo or other identifying information.

3) The tangible personal property a) is made from raw materials produced on the reservation; b) reflects or illustrates tribal history, culture or tradition; c) is intended for use in an on-reservation activity; or d) is not generally available for purchase outside of a reservation.

As explained by a tribal representative, an example of the first exception would be to the sale of property such as T-shirts, mugs, and gaming supplies that display a casino or tribal logo. The second exception, also as explained by a tribal representative, would apply to, for example, a) the sale of lumber produced on the reservation from trees grown on the reservation; b) tribal artifacts and jewelry; c) the sale or lease of inner-tubes used in water parks on the reservation; or d) items specific to the tribe such as T-shirts with tribal logo.

CNIGA believes that the proposed language clearly establishes the criteria that should be met to relieve the Indian retailer from the duty to collect use tax from its customers. Furthermore, CNIGA believes the proposed revisions are consistent with federal Indian law principles on tribal sovereignty, as well as the federal common law, as provided in the analysis by tribal representatives, set forth in Exhibit 2. Staff is presenting CNIGA's proposal.

The revenue loss from this recommendation is estimated at $1.4 million annually. See Revenue Estimate (Exhibit 1). In regard to cost impact, it is anticipated that taxpayers would be notified of the amendments to the regulation through an article in one of the scheduled Tax Information Bulletins (TIBs). The cost associated with the distribution of TIBs, which are routinely prepared and distributed to taxpayers, are accommodated within the Board's existing budget.

Submission Made by Collier

It is NACS and SIGMA's position that, particularly in light of the refusal by Native American tribes and tribal businesses around the country to collect and remit legally imposed taxes, state tax exceptions for Native American businesses should be no broader than legally required. NACS and SIGMA urge the Board to act consistent with current law, and reject any proposal to create exceptions to the requirement to collect and remit taxes on the sale of tangible personal property to non-Native Americans on reservations. NACS and SIGMA believe that opening any loophole will only invite tax avoidance and abuses.

In its submission on behalf of NASC and SIGMA, Collier states that the United States Supreme Court has consistently held that states may require Native American tribes and enrolled members of those tribes operating businesses on the reservation to collect and remit to states sales, excise and use taxes properly imposed on non-Native Americans making purchases on the reservation. Collier states that the Discussion Paper [issued by staff on September 20, 2002] indicates that there are exceptions to the ability of the state to impose its regulations on an Indian tribe's transactions with non-Native Americans, where the transactions have sufficient "reservation-based value." However, Collier notes that none of the cited cases reaches this result in the context of sales of tangible personal property.

Furthermore, Collier urges that, should the Board decide to provide an exception for Indian retailers, the exception should be drawn as narrowly as possible, and such a narrow exception should only be made for personal property that is completely manufactured on the Indian retailer's reservation. Collier also urges the Board to include protections to curtail potential abuses of the exception. These protections should include strict limits on the volume of tax-exempt product purchases by consumers in order to limit the opportunity for consumers to buy those products tax-free and resell them outside the reservation.

Collier also recommends that the Board remove the phrase "Indian organization" from the definition of "Indian" in subdivision (d)(2) of the regulation in order to clear up potential ambiguity. Collier indicates it is unclear what a "tribal organization" is, and questions whether the term includes any organization under tribal authority even if it is owned or run (in whole or in part) by non-Native Americans. Since the recommendation is beyond the scope of this topic, as directed by the Board, the recommendation will not be further addressed in this regulatory amendment process.

Conclusion:

As directed by the Board, staff worked with interested parties to facilitate the submission of regulatory language that would add exceptions to the obligation of on-reservation Indian retailers to collect use tax on the sale of tangible personal property with reservation-based value. CNIGA, with the support of Indian tribes, submitted proposed language to satisfy the Board's stated objective regarding sales by on-reservation Indian retailers.

NACS and SIGMA oppose any amendments to Regulation 1616. On their behalf, Collier submitted opposing arguments for Board consideration. Should the Board decide to adopt any exception to the duty to collect use tax based on the "reservation-based value" concept, Collier urges the Board to draw the exception as narrowly as possible and to include protections to curtail potential abuses of the exception.

Before the Board for its consideration and approval is regulatory language submitted by CIGNA, with the support of tribal representatives. If the language submitted by CIGNA is not approved by the Board, the only amendment to Regulation 1616 is the amended regulatory language, already adopted by the Board, relieving Indian retailers from the duty to collect use tax on the sale of meals, food and beverages sold at eating and drinking establishments for consumption on the reservation.

Prepared by: Program Planning Division, Sales and Use Tax Department

Current as of: 10-30-02

State of California
Memorandum

Board of Equalization
Administration Department

To : Ramon Hirsig
Deputy Director,
Sales and Use Tax Department

Date : October 18, 2002

From : Bill Benson, Jr.
Research & Statistics Section

Subject : Regulation 1616 (d), *Federal Areas – Indian Reservations*

In December 2001, in conjunction with an issue paper on proposed clarification of the application of tax to sales by retailers on Indian reservations, the Research and Statistics Section prepared a revenue estimate on the proposals to amend Regulation 1616 (d), *Federal Areas.* The proposed amendments were to relieve Indian retailers from the duty to collect use tax on the sale of meals, food and beverages sold at eating and drinking establishments for consumption on the reservation, and on the sale of other tangible personal property having "reservation-based value."

On March 27, 2002, the Board held a public hearing and adopted proposed amendments to Sales and Use Tax Regulation 1616. During the regulatory review process, the Office of Administrative Law (OAL) raised necessity, consistency and clarity objections, and stated that it would reject the amendments regarding "reservation-based value" under the clarity standard (Government Code section 11349.1). OAL stated that the proposed definitions of reservation-based value did not give adequate guidance as to the criteria for property having reservation-based value. On July 16, 2002, staff withdrew the proposed amendments to the regulation in lieu of OAL rejecting the proposed changes. On September 12, 2002, the Board, in consideration of OAL's objections regarding clarity, approved amendments related only to the meals, food and beverages sold at eating and drinking establishments for consumption on the reservation, and directed staff to begin a new regulatory process regarding reservation-based value.

The proposed new revisions provide exceptions to the Indian retailer's obligation to collect and remit use tax on sales of tangible personal property with value-added on the reservation to non-Indians and Indians not residing on a reservation. The proposed exceptions would apply when federal statute preempts state regulations or policies obligating Indian retailer's to collect the use tax. These exceptions would apply to tangible personal property intended for use in on-reservation gaming activities, advertisement, promoting patronage of tribal gaming facilities, and for any display of the tribe's name, logo, or other identifying information. For example, the sale of T-shirts, mugs, and gaming supplies that display a casino or tribal logo. The exceptions would also apply when tangible personal property is made from raw materials produced on the reservation, when the property illustrates tribal history, culture or tradition, or when not generally available for purchase outside the reservation, for example, the sale of tribal artifacts or jewelry.

Based on information from the sales and use tax returns that we analyzed in December 2001, we estimate that annual the sale of items, as identified above, for which use tax is currently being collected, amounts to an estimated $17 million. The state and local use tax revenue collected on these sales amounts would be as follows:

	Revenue Effect
State loss (5%)	$ 0.9 million
Local loss (2.25%)	0.4 million
Transit loss (0.67%)	0.1 million
Total	$ 1.4 million

BBJr:ap

cc: Mr. Dave Hayes
Ms. Charlotte Paliani

Regulation 1616. FEDERAL AREAS.

(d) INDIAN RESERVATIONS.

(1) IN GENERAL. Except as provided in this regulation, tax applies to the sale or use of tangible personal property upon Indian reservations to the same extent that it applies with respect to sale or use elsewhere within this state.

(2) DEFINITIONS. For purposes of this regulation "Indian" means any person of Indian descent who is entitled to receive services as an Indian from the United States Department of the Interior. Indian organizations are entitled to the same exemption as are Indians. "Indian organization" includes Indian tribes and tribal organizations and also includes partnerships all of whose members are Indians. The term includes corporations organized under tribal authority and wholly owned by Indians. The term excludes other corporations, including other corporations wholly owned by Indians. "Reservation" includes reservations, rancherias, and any land held by the United States in trust for any Indian tribe or individual Indian.

(3) SALES BY ON-RESERVATION RETAILERS.

(A) Sales by Indians.

1. Sales by Indians to Indians who reside on a reservation. Sales tax does not apply to sales of tangible personal property made to Indians by Indian retailers negotiated at places of business located on Indian reservations if the purchaser resides on a reservation and if the property is delivered to the purchaser on a reservation. The purchaser is required to pay use tax only if, within the first 12 months following delivery, the property is used off a reservation more than it is used on a reservation.

2. Sales by Indians to non-Indians and Indians who do not reside on a reservation. Sales tax does not apply to sales of tangible personal property by Indian retailers made to non-Indians and Indians who do not reside on a reservation when the sales are negotiated at places of business located on Indian reservations if the property is delivered to the purchaser on the reservation. Except as exempted below, or as expressly preempted by federal statute, regulation or policy, Indian retailers are required to collect use tax from such purchasers and must register with the Board for that purpose:

a. Indian retailers selling meals, food or beverages at eating and drinking establishments are not required to collect use tax on the sale of meals, food or beverages that are sold for consumption on an Indian reservation;

b. Indian retailers are not required to collect use tax on the sale of tangible personal property sold on a reservation, without regard to the origin of such tangible personal property, if the tangible personal property is intended for use in on-reservation gaming activities, or to advertise or promote patronage of a tribal gaming facility through the display of the facility's or the tribe's name, logo or other identifying information.

c. Indian tribes/Indian retailers are not required to collect use tax on the sale of tangible personal property sold on a reservation if the property a) is made from raw materials produced on the reservation, b) reflects or illustrates tribal history, culture or tradition, c) is intended for use in an on-reservation activity, or d) is not generally available for purchase outside of a reservation.

(B) Sales by non-Indians.

1. Sales by non-Indians to Indians who reside on a reservation. Sales tax does not apply to sales of tangible personal property made to Indians by retailers when the sales are negotiated at places of business located on Indian reservations if the property is delivered to the purchaser on a reservation. The sale is exempt whether the retailer is a federally licensed Indian trader or is not so licensed. The purchaser is required to pay use tax only if, within the first 12 months following delivery, the property is used off a reservation more than it is used on a reservation.

2. Sales by non-Indians to non-Indians and Indians who do not reside on a reservation. Either sales tax or use tax applies to sales of tangible personal property by non-Indian retailers to non-Indians and Indians who do not reside on a reservation.

(C) Resale Certificates. Persons making sales for resale of tangible personal property to retailers conducting business on an Indian reservation should obtain resale certificates from their purchasers. If the purchaser does not have a permit and all the purchaser's sales are exempt under paragraph (d)(3)(A) of this regulation, the purchaser should make an appropriate notation to that effect on the certificate in lieu of a seller's permit number (see Regulation 1668, "Resale Certificates").

(4) SALES BY OFF-RESERVATION RETAILERS.

(A) Sales Tax - In General. Sales tax does not apply to sales of tangible personal property made to Indians negotiated at places of business located outside Indian reservations if the property is delivered to the purchaser and ownership to the property transfers to the purchaser on the reservation. Generally ownership to property transfers upon delivery if delivery is made by facilities of the retailer and ownership transfers upon shipment if delivery is made by mail or carrier. Except as otherwise expressly provided herein, the sales tax applies if the property is delivered off the reservation or if the ownership to the property transfers to the purchaser off the reservation.

(B) Sales Tax - Permanent Improvements - In General. Sales tax does not apply to a sale to an Indian of tangible personal property (including a trailer coach) to be permanently attached by the purchaser upon the reservation to realty as an improvement if the property is delivered to the Indian on the reservation. A trailer coach will be regarded as having been permanently attached if it is not registered with the Department of Motor Vehicles. Sellers of property to be permanently attached to realty as an improvement should secure exemption certificates from their purchasers (see Regulation 1667, "Exemption Certificates").

(C) Sales Tax - Permanent Improvements - Construction Contractors.

1. Indian contractors. Sales tax does not apply to sales of materials to Indian contractors if the property is delivered to the contractor on a reservation. Sales tax does not apply to sales of fixtures furnished and installed by Indian contractors on Indian reservations. The term "materials" and "fixtures" as used in this paragraph and the following paragraph are as defined in Regulation 1521 "Construction Contractors."

2. Non-Indian contractors. Sales tax applies to sales of materials to non-Indian contractors notwithstanding the delivery of the materials on the reservation and the permanent attachment of the materials to realty. Sales tax does not apply to sales of fixtures furnished and installed by non-Indian contractors on Indian reservations.

(D) Use Tax - In General. Except as provided in paragraphs (d)(4)(E) and (d)(4)(F) of this regulation, use tax applies to the use in this state by an Indian purchaser of tangible personal property purchased from an off-reservation retailer for use in this state.

(E) Use Tax - Exemption. Use tax does not apply to the use of tangible personal property (including vehicles, vessels, and aircraft) purchased by an Indian from an off-reservation retailer and delivered to the purchaser on a reservation unless, within the first 12 months following delivery, the property is used off a reservation more than it is used on a reservation.

(F) Leases. Neither sales nor use tax applies to leases otherwise taxable as continuing sales or continuing purchases as respects any period of time the leased property is situated on an Indian reservation when the lease is to an Indian who resides upon the reservation. In the absence of evidence to the contrary, it shall be assumed that the use of the property by the lessee occurs on the reservation if the lessor delivers the property to the lessee on the reservation. Tax applies to the use of leased vehicles registered with the Department of Motor Vehicles to the extent that the vehicles are used off the reservation.

This memorandum has been prepared by certain attorneys representing California Indian Tribes to address the legal basis for the Board of Equalization adopting an amendment to Regulation 1616 to include an exemption for categories of sales that would have a reservation-based value. The five categories include: 1) items related to gaming activities on the reservation; 2) items that are made from raw materials produced on the reservation; 3) items that reflect or illustrate tribal history, culture or tradition, 4) items intended for use in an on-reservation activity; and 5) items that are not generally available for purchase outside of an Indian reservation. Federal Indian law principles based on tribal sovereignty, as well as the federal common law not only support the proposed amendment, but require that it be adopted.

Introduction

The concept of added value was first articulated in Washington v. Confederated Tribes of the Colville Indian Reservation, 447 U.S. 134, at 156-157 (1980), as a factor to be considered when balancing tribal, state and federal interests in the imposition of state sales and excise taxes. The Court reasoned that the tribal interest "is strongest when the revenues are derived from value generated on the reservation by activities involving the Tribes and when the taxpayer is the recipient of tribal services." Id. The Supreme Court has found that tribal interests outweigh state and federal interests in the regulation of certain specific on-reservation activities such as hunting, fishing, and gambling. See, New Mexico v. Mescalero Apache Tribe, 462 U.S. 324 (1983) (hunting and fishing); California v. Cabazon, 480 U.S. 202 (1987) (tribal gaming). Where value is generated on Indian lands through activities in which the tribe has a substantial interest there is said to be a "reservation-based value" in the sale.

Analysis

I. **Proposed Regulation 1616(d)(3)(A)2.b.**

The proposed amendment to Regulation 1616(d)(3)(A)2.b. reads:

Indian tribes/Indian retailers are not required to collect use tax on the sale of tangible personal property sold on a reservation, without regard to the origin of such tangible personal property, if the tangible personal property is intended for use in on-reservation gaming activities, or to advertise or promote patronage of a tribal gaming facility through the display of the facility's or the tribe's name, logo or other identifying information.

United States Supreme Court and Ninth Circuit Court of Appeals decisions support the conclusion that tangible personal property of the kind described above is exempt from any state taxation because the pervasive federal regulation of the Indian gaming industry under the Indian Gaming Regulatory Act, 25 U.S.C. § 2701 et seq. ("IGRA") indicates a heightened federal and tribal interest and preempts the state interest in taxation for the purpose of raising revenue. The existing Regulation 1616, as it pertains to the imposition of a use tax on non-Indian consumption or use of personal property or services on the premises of tribal gaming facilities, rests upon the premise that if the legal incidence of the tax falls on a non-Indian, there are no circumstances under which the State jurisdiction to impose that tax is preempted. This premise is fundamentally flawed, because it fails accurately to interpret and apply the Supreme Court's holding in Oklahoma Tax Commission v. Chickasaw Nation 515 U.S. 450, 115 S.Ct. 2214 (1995) and fails to consider the preemptive effect of the IGRA, as construed by the Ninth Circuit in Cabazon Band of Mission Indians, et al. v. Wilson 37 F.3d 430, 124 F.3d 1050 (1994).

Until now, the Board's position has been that under the U.S. Supreme Court's decisions in Moe v. Confederated Salish and Kootenai Tribes, 425 U.S. 463 (1976), and Washington v. Confederated Tribes 447 U.S. 134 (1980), as long as the legal incidence of the State tax falls on a non-Indian, the State is free to impose the tax and force the Tribe to collect it on the State's behalf. There can be no doubt that in Moe v. Confederated Salish and Kootenai Tribes, and Washington v. Confederated Tribes, the Supreme Court held that in the specific circumstances presented in those cases, the states in which the reservations were located could tax on-Reservation purchases of tobacco products by non-Indians, and also could require that Indian retailers collect the taxes from non-Indian taxpayers and remit those taxes to the State.

However, there also can be no doubt that neither Moe v. Confederated Tribes, Washington v. Confederated

Tribes, nor any other Supreme Court decision ever has established a per se rule that a State may tax any on-Reservation sale of goods to a non-Indian in the absence of a federal statute expressly exempting the transaction from State taxation. Indeed, the opposite would appear to be true; as the Supreme Court later noted in California v. Cabazon, supra, the presumption of the Court is that, absent affirmative Congressional consent, a State has no jurisdiction to impose or require the collection in Indian country of any tax the legal incidence of which falls on a Tribe or members of that Tribe. If there is no Congressional consent, and the legal incidence falls on a non-Indian, then the Court will turn to a balancing test to determine the relevant tribal and federal interests vs. the state's interests. Goodman Oil v. Idaho Tax Comm'n, 28 P.2d 996 (Idaho 2001), cert. denied, 122 S.Ct. 1068 (2002); Oklahoma v. Chickasaw Nation, supra.

In Washington v. Confederated Tribes, the Supreme Court began its analysis of the State's jurisdiction to tax transactions involving non-Indians by inquiring whether Congress had expressly exempted such transactions from taxation. Having found no express preemption of the State's jurisdiction to tax its own citizens for their on-Reservation purchases, the Court proceeded to determine whether the State's jurisdiction had otherwise been preempted. It did so by first finding the incidence was on the purchaser, then identifying and balancing the relevant State, Tribal and federal interests implicated by the State tax and collection scheme.

The Supreme Court found that even though the Tribe also could tax the transactions, the State's legitimate interest in raising revenues from its own citizens, with which the State would provide services to those same taxpayers outside of Reservation boundaries, was not outweighed by Tribal and/or federal interests in Reservation economic development and self-government 447 U.S. 134, 155-156. One factor that the Supreme Court found extremely relevant in its balancing of interests was that the only reason non-Indians were going onto the Reservations was to purchase tobacco products free of State taxation; there was nothing unique about the Reservation situs of the transactions that added any value to the commodities being sold. Id. at 172.

Significantly, the Supreme Court did not hold that the State could enter onto Reservation lands to enforce collection of its tax, or that the State could condition a Tribe's ability to engage in business on its own Reservation upon compliance with State tax collection laws. Rather, the Court clearly recognized that the State might be limited to indirect remedies, such as seizure of untaxed tobacco products destined for Reservations. In Oklahoma Tax Commission v. Citizen Band Potawatomi Indian Tribe (1991), 498 U.S. 505, the Supreme Court explicitly held that Congress never has authorized suits against Tribes to enforce State tax assessments, and thus that a Tribe's sovereign immunity precludes a State from proceeding directly against a Tribe to enforce a Tribe's obligation to collect an applicable tax on non-Indians.[1]

The enactment of IGRA fundamentally altered the nature and weight of the relevant State, Tribal and federal interests that are to be balanced in determining whether the State jurisdiction to impose and enforce collection of its use taxes has been preempted. Unlike the individual Indians and/or Tribal retailers involved in Moe v. Confederated Tribes, Washington v. Confederated Tribes, or even California State Board of Equalization v. Chemehuevi Indian Tribe (1985) 474 U.S. 9) and Oklahoma Tax Commission v. Potawatomi Indian Tribe, who merely imported tobacco products onto Reservations for retail sale to consumers in smoke shops or convenience stores without express federal statutory sanction, tribes do not build and pay for their casinos for the purpose of establishing a retail outlet for the tax-free sale of the same tobacco products that consumers could purchase throughout the State. Rather, Tribes establish casinos as Tribal governmental gaming enterprises pursuant to IGRA in order to generate revenues needed to fund the operation of Tribal governments, provide vital governmental services to reservation communities (services that no other government provides), and to provide meaningful employment for Tribal members in reservation-based economic activity -- among the very purposes for which IGRA was enacted.

The Supreme Court has found that when the federal government, by statute and regulatory oversight, becomes pervasively involved in an on-reservation activity, the federal and tribal interests are very great, and the

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[1] Throughout the decision, the Court referred to "applicable" taxes on non-Indians. The Court did not assume that a State necessarily could tax non-Indians or force a Tribe to collect such taxes for the State.

state's interest in raising revenue through taxation is correspondingly weaker. This is preemption. New Mexico v. Mescalero Apache Tribe, 462 U.S. 324, 103 S.Ct. 2378 (1983); Ramah Navajo School Board, Inc. v. Board of Revenue of New Mexico, 458 U.S. 832 (1982); White Mountain Apache v. Bracker, 448 U.S. 136 (1980). Through the IGRA and the authority delegated to the National Indian Gaming Commission, the federal government is pervasively involved in Indian gaming in California to the extent that relevant State taxation is preempted. The tangible personal property sold on reservations in direct connection with gaming activities, as described by this proposed regulation, are exempt from State taxation under a preemption analysis.

Although the gaming activity that Tribes offer in their gaming facilities is "permitted" in California within the meaning of IGRA, the scale, scope and variety of gaming activities offered by Tribes cannot be found outside Indian country in California. Indeed, but for Tribes' establishment and operation of casinos, it is fair to say that non-Indians would not come to reservations at all, and the transactions that Regulation 1616 would tax would not occur.

People do not go to reservations primarily to purchase the goods and services that existing Regulation 1616 otherwise would tax, however, the availability of gaming-related items to patrons of tribal casinos is an important element in the Tribes' ability to accommodate their gaming customers' needs while on Tribal premises. Under these circumstances, the "reservation-based value" component to these transactions is so strong as to preempt any jurisdiction California otherwise might have to impose its use tax on the use or consumption of such goods or services.

II. Proposed Regulation 1616(d)(3)(A)2.c.

The proposed language of Regulation 1616(d)(3)(A)2.c. reads as follows:

Indian tribes/Indian retailers are not required to collect use tax on the sale of tangible personal property sold on a reservation if the property a) is made from raw materials produced on the reservation, b) reflects or illustrates tribal history, culture or tradition, c) is intended for use in an on-reservation activity, or d) is not generally available for purchase outside of a reservation.

a) Items made from raw materials produced on the reservation

The section reads in relevant part: "Indian tribes/Indian retailers are not required to collect use tax on the sale of tangible personal property sold on a reservation if the property a) is made from raw materials produced on the reservation…."

There is substantial case law to support the clear enunciation that if the raw materials which make up the product are from the reservation, the state has no right to tax their sale. Beginning with *New Mexico v. Mescalero Apache Tribe*, 462 U.S. 324, 103 S.Ct. 2378 (1983) (hereinafter "*Mescalero Apache*"), the Supreme Court and the Ninth Circuit Court of Appeals have heard a series of cases concerning state taxation of reservation resources.

In *Mescalero Apache,* the state attempted to impose its hunting and fishing license fees on non-members on the reservation. The Court recognized that "[w]hile under some circumstances a State may exercise concurrent jurisdiction over non-Indians acting on tribal reservations, such authority may be asserted only if not preempted by the operation of federal law." 462 U.S. at 333 (citations omitted). The Court explains what it means by "federal law" by stating, "State jurisdiction is preempted by the operation of federal law if it interferes or is incompatible with federal and tribal interests reflected in federal law, unless the State interests at stake are sufficient to justify the assertion of State authority." 462 U.S. at 335.

This is the balancing test the Court must perform. First, the Court analyzes the federal and tribal interests. In *Mescalero Apache* it was recognized that the right of the tribe to be independent of the state licensing scheme for fish and game was important to the Tribe and to the Federal Government for many reasons. The Tribe's management of its fish and game resources without state interference furthers the goal of self-government, self-

sufficiency, and economic development. 462 U.S. at 335. And the Court recognized a long history of cases which "have held that tribes have the power to manage the use of its[sic] territory and resources by both members and nonmembers, to undertake and regulate economic activity within the reservation, and to defray the cost of governmental services by levying taxes." *Id*. (citations omitted).

Mescalero Apache describes exactly the tribal and federal interests we find in the sale of tangible personal property made from raw materials produced on the reservation. The extraction of the raw materials involves the tribe's right to manage the use of its territory and its resources. The tribe's ability to manage its own resources free from state interference furthers the tribal and Congressional goals of self-government, self-sufficiency, and economic development.

Mescalero Apache also inquires into the state's interest in the tax. "Thus a State seeking to impose a tax on a transaction between a Tribe and nonmembers must point to more than its general interest in raising revenues." *Id.* at 336. The Court finds that "[t]his case is thus far removed from those situations, such as on-reservation sales outlets which markets to nonmembers goods not manufactured by the tribe or its members, in which the tribal contribution to an enterprise is *de minimis*." *Id*. at 341. It is fitting that this description is nearly the exact opposite of what the proposed Regulation exempts from state taxation. The proposed regulation is justified under the *Mescalero Apache* analysis because the state's interest will always be minimal: no more than a general interest in raising revenue. And the Tribe's interest in the sale of tangible personal property which is made from raw materials produced on the reservation will always be much greater than a sales outlet which markets to nonmembers goods not manufactured by the tribe or its members, in which the tribal contribution to an enterprise is *de minimis*.

The proposed Regulation concerns the sale of a resource of the reservation, therefore the interests of the tribe and federal government in tribal self-government and self-sufficiency are at stake, and the state's interest is minimal. Under the Supreme Court's analysis in *Mescalero Apache*, tangible personal property sold on the reservation by an Indian entity which is made from raw materials produced on the reservation will always be exempt from state taxation.

The Ninth Circuit Court of Appeals considered a case involving the natural resources of a tribe in *Crow Tribe v. Montana*, 819 F.2d 895 (9th Cir. 1987) (hereinafter "*Crow Tribe*"). The state attempted to impose an excise tax on coal mined from the reservation. The Court closely followed the Supreme Court's decisions in *California v. Cabazon,* 480 U.S. 202 (1987), and *Mescalero Apache*, and found because the coal is a resource of the reservation, "a component of the reservation land itself," the state tax would threaten the tribal and federal interests in tribal self-government and economic development. 819 F.2d at 902-903. *Crow Tribe* reinforces the decision in *Mescalero Apache* that when a natural resource of the reservation is at issue, the tribal and federal interests are much stronger and the state interests are much weaker.

The Ninth Circuit Court of Appeals considered another case involving the natural resources of a tribe in *Hoopa Valley Tribe v. Nevins*, 881 F.2d 657 (9th Cir. 1989) (hereinafter "*Hoopa*"), wherein the state attempted to impose a timber yield tax on timber harvested on the reservation. In *Hoopa* the Court determined that the state could not impose the timber yield tax because "[t]he state's general interest in revenue collection is insufficient to outweigh the specific federal and tribal interests with which the timber yield tax interferes." *Id*. at 661. Again, the Court weighs the tribal and federal interests against the state's interest. The tax involves timber, an on-reservation resource, therefore the tribal and federal interests are significant, involving the tribe's right to self-government of its territory, and self-sufficiency and economic development. The tax is not tied to any relevant state program, therefore the state's interest is only in general revenue. The tribal and federal interests prevail.

In the proposed Regulation the tax involves an on-reservation resource, because the raw materials are from the reservation, which means that the tribal and federal interests are significant, and involve the tribe's right to self-government of its territory, management of its resources, self-sufficiency, and economic development. The State's interest in the use tax on the sale of tangible personal property is limited to an interest in general revenue. Therefore under all of the applicable law the tribal and federal interests will always prevail in this category.

b) **Item reflects or illustrates tribal history, culture, or tradition**

The section reads in relevant part: "Indian tribes/Indian retailers are not required to collect use tax on the sale of tangible personal property sold on a reservation if the property b) reflects or illustrates tribal history, culture, or tradition."

This proposed exception is intended to exempt from state taxation those items which relate to an intangible resource of the tribes: their unique history, culture and traditions. One reason this exemption is required by law is that the level of federal regulation in this area is pervasive. In *White Mountain Apache v. Bracker*, 448 U.S. 136 (1980), the Court reviewed the tax of the state of Arizona on motor carriers of timber on the reservation. The Court held that the state taxes were preempted by the tribal and federal interests in part because the federal government's regulation and oversight of the timber harvest on the reservation was so pervasive that state taxation was an interference. In addition, the state could not show any particularized interest in the tax because the roads were maintained by the Tribe and the Bureau of Indian Affairs (BIA).

In *Ramah Navajo School Board v. Bureau of Revenue*, 458 U.S. 832 (1982), the Court held that the state could not tax the construction contractor because the BIA was again closely involved in the project and the state's interest was minimal. The Court cited to the numerous statutory and regulatory provisions which applied to the project.

The *Mescalero Apache* Court noted that federal statutes support the Tribe's jurisdiction over the management of fish and game resources. Public Law 280 specifically confirms the power of tribes to regulate on-reservation hunting and fishing, and federal criminal law prohibits non-members from entering Indian land to hunt, trap, or fish without the consent of the tribe, and it is a violation to import, export, transport, etc. fish or wildlife taken or possessed in violation of tribal law. *Id*. at 338. This level of federal involvement is relevant to demonstrate the federal interests at issue.

The federal government is extensively involved in the protection of tribal history, culture, and traditions. The federal government has recognized for many years that others besides Native Americans have profited from tribal history, culture, and traditions at the expense of tribal interests. The federal government has paid close attention to this area, passing laws such as the creation of the Indian Arts and Crafts Board, 25 U.S.C. § 305a, 25 C.F.R. Part 309 (protecting tribal arts and crafts from illegitimate marketing), the Native American Graves Protection and Repatriation Act, 25 U.S.C. § 3001 et seq. (regulating ownership and excavation of tribal ancestral remains and items), the American Indian Religious Freedom Act, 42 U.S.C. § 1996, et seq. (protecting rights of Indian tribes to freely exercise their religions), Executive Order 13007 (protecting tribal sacred sites from damage and granting tribal members access to them), and the Native American Languages Act, 25 U.S.C. § 2901 et seq. (promoting preservation of Native languages).

Therefore, as in the management of timber in *White Mountain Apache*, the construction of an Indian school in *Ramah*, and the management of fish and game in *Mescalero Apache*, the federal government has demonstrated by its actions that it takes a significant interest in the sale of tangible personal property which reflects or illustrates tribal history, culture, or traditions. Any attempt by a state to impose a tax on the sale of said tangible personal property on a reservation would be invalidated by the federal courts because of the substantial tribal and federal interests at issue, and the lack of any significant state interest.

In addition, the sale of tangible personal property which reflects or illustrates tribal history, culture, or traditions would be exempt from state taxation under the same analysis as was applied above to the tangible personal property made from raw materials produced on the reservation. The only difference is that in this case the resource at issue is the intangible, "intellectual property"-type resources of the tribe, rather than its physical resources. This is similar to the facts in *Cabazon*, where it was the services and opportunities offered by the tribe on its reservation that drew non-Indians, rather than a natural resource. But just as the Court in *Crow Tribe* found that the coal is "a component of the reservation itself," 819 F.2d at 902-903, so would any court find that tangible personal property which reflects or illustrates tribal history, culture, or traditions is a component of the tribe itself,

and just as much an inherent resource of the tribe. Any attempt by the state to tax in this area would, as with the fish and game in *Mescalero Apache*, the gaming in *Cabazon*, and the timber in *Hoopa*, threaten the tribal and federal interests in tribal self-government, self-sufficiency, and economic development.

The proposed Regulation is narrowly drafted to accomplish the purpose of exempting from taxation certain categories of tangible personal property which under federal case law are clearly exempt from state taxation.

c) **Items intended for use in an on-reservation activity**

The section reads in relevant part: "Indian tribes/Indian retailers are not required to collect use tax on the sale of tangible personal property sold on a reservation if the property c) is intended for use in an on-reservation activity…"

The difficulty in articulating reservation-based value is, in part, due to the inherent rights of tribes that are not quantifiable. No Supreme Court case or statute has stated a definition for reservation-based value, and no Supreme Court case or statute has set forth a per se rule that a state may tax the sale of items intended for use in an on-reservation activity. In fact, the United States Supreme Court has established a firm per se general rule prohibiting states from taxing Indian tribes and their members for activities occurring within Indian country. Oklahoma Tax Comm'n v. Chickasaw Nation, 515 U.S. 450, 458 (1995) (citations and internal quotations omitted) (emphasis supplied.) See also White Mountain Apache Tribe v. Bracker, 448 U.S. 136, 144 (1980) ("When on-reservation conduct involving only Indians is at issue, state law is generally inapplicable…").

This per se bar on state taxation of Indian activities within Indian country can be overcome only if Congress ***explicitly*** authorizes the tax. This standard is set very high. The Supreme Court repeatedly has recognized a strong presumption against such state taxes. Oklahoma Tax Comm'n v. Sac and Fox Nation, 508 U.S. 114, 128 (1993) (emphasis added). The state tax "cannot be enforced absent ***clear*** congressional authorization." Chickasaw, 515 U.S. at 459 (emphasis supplied). The Supreme Court "consistently has held that it will find the Indians' exemption from state taxes lifted only when Congress has made its intention to do so ***unmistakably clear***." Montana v. Blackfeet Tribe, 471 U.S. 759, 765 (1985) (emphasis supplied). Congress has never ***explicitly*** or ***specifically*** authorized any state, to tax the sale of items intended for use in purely on-reservation activities.

In recent 9th Circuit cases, however, the court has given greater weight to the incidence of the tax when going through a balancing test of tribal, state and federal interests. See, Yavapai-Prescott Indian Tribe v. Scott, 117 F.3d 1107 (9th Cir. 1997) (business transaction tax on room rentals and room service); Gila River Indian Community v. Waddell, 91 F.3d 1232 (9th Cir. 1996): (transaction privilege tax on ticket sales for on-reservation events); Salt River Pima-Maricopa Indian Community v. Arizona, 50 F.3d 734 (9th Cir. 1995) (sales and rentals by non-Indian businesses). In each case, the court found that the incidence of the tax fell mostly on non-Indian purchasers or participants. The incidence of the tax was important when the court applied a balancing test to determine the tribal and state interests. On balance, the court looked at a variety of factors to determine whether the tribe had an "active role" in the creation of the value taxed in order to establish preemption. In each case, as set forth below, the court found that the tribe did *not* have a sufficient interest in the activity to preempt the state tax. However, the cases must be viewed with the understanding that the retailers in each case would probably not be considered Indian retailers under Regulation 1616. Consequently, the cases are not directly applicable to the analysis of reservation-based value except to point out that the definition of Indian retailer, Indian tribe, or Indian organization is what drives the exemption for items intended for use in on-reservation activity.

In Yavapai-Prescott, the court reviewed the assessment of a business transaction privilege tax on room rentals, and food and beverage sales. The court found that the federal and tribal interests did not outweigh the state interests pertaining to room rentals and food and beverage sales in a hotel owned and operated by a non-Indian company on leased tribal lands. The tribe was not active in the operation of the hotel, and the tribe had only a fractional financial interest in the revenue from the hotel. Id. With regard to the food and beverage sales, the court found that the tribe contributed virtually nothing to the food and beverage sales because the hotel restaurant was owned and operated by the lessee. Id. Consequently, the record in Yavapai-Prescott did not support a claim that the tribe added value to the sale through its substantial interest in the activity in order to preempt the state tax.

In Gila River, the court was presented with a case involving the assessment of a transaction privilege tax on the ticket and concession sales in connection with sporting and cultural events on the reservation. The court found, similar to the Yavapai-Prescott case, that the tribe had not shown that its involvement was substantial enough to tip the scales in its favor when balancing the interests of the tribe and state. The tribe had no control over events, promotion, ticket sales, or concessions. Id. Most importantly, the court stated that even if it were not able to find the tribe's contributions significant, the court's analysis could also be influenced by the fact that the activity is a "major source of employment for tribal members," and the profits "the Tribe's sole source of income," but that neither of those factors was present in the case. Id. at 1238, citing California v. Cabazon Band of Mission Indians, et al. 480 U.S. 202 at 218-219, 107 S.Ct. 1083 at 1093-94 (1987).

In Salt River, the 9th Circuit reviewed a challenge of state sales taxes imposed on non-Indian sellers to non-Indian buyers on an Indian reservation. The court found that the tax was not preempted by the tribe's concurrent taxation where the tribe's activities did not contribute to the value of goods sold and the state provided most governmental services, such as fire protection, road maintenance, and access ramp). The facts involved the lease of individual Indian allotted lands to a non-Indian land developer. The developer then sublet the property to various non-Indian businesses, including Circuit City, Clothestime, Cost Plus Imports, Denny's, J.C. Penney, McDonalds, Taco Bell, Kentucky Fried Chicken and Home Depot. Id. at 735. The issue before the court was whether the state taxes on the sale of non-Indian goods to a non-Indian by a non-Indian business on a reservation are preempted when the tribe concurrently taxes and provides some of the governmental services used by the non-Indian businesses. Id. at 736. The court held that the tax was proper because the tribe's activities did not contribute to the value of the goods sold.

While these cases make the issue of reservation-based value unclear, an important factual distinction can be made between the Arizona cases, and the facts presented by assessing use tax on sales of items intended for use in an on-reservation activity. The primary distinction is that the facts presented in the Arizona cases did not support the contention that the tribe had a "substantial interest" or "active role" in the creation of value taxed. In essence, the seller in each case was not an "Indian Retailer" under the definition in Regulation 1616. Since the seller would not be considered an Indian Retailer under Regulation 1616, the exemptions under proposed Regulation 1616(d)(3)(A)2 would not apply.

Finally, and most importantly, the controlling precedent for taxation of on-reservation activities is still the Supreme Court's line of tax cases, specifically, Oklahoma Tax Comm'n v. Sac and Fox Nation, 508 U.S. 114, 128 (1993), Chickasaw, 515 U.S. at 459, and Montana v. Blackfeet Tribe, 471 U.S. 759, 765 (1985) (emphasis supplied). The rule continues to be that Congress has never ***explicitly*** or ***specifically*** authorized any state, to tax the sale of items intended for use in purely on-reservation activities. Regulation 1616 should be amended to properly reflect this long-standing rule.

d) **Items not generally available for purchase outside of a reservation**

The section reads in relevant part: "Indian tribes/Indian retailers are not required to collect use tax on the sale of tangible personal property sold on a reservation if the property d) is not generally available for purchase outside of a reservation."

In California v. Cabazon Band of Mission Indians, 480 U.S. 202 (1987) (hereinafter "Cabazon"), the Court held that the state could not regulate on-reservation gaming because the tribe was generating value on the reservation and the tribe had a substantial interest in the activities. The Cabazon decision, like Mescalero Apache v. Jones, 411 U.S. 145 (1973), concerns the tribal and federal interests inherent in value which is generated on the reservation from by an Indian retailer. In Cabazon the resource is not naturally occurring, but rather is generated by the services and opportunities being offered at the reservation. The Court evaluated this resource in the same way as the natural resources in Mescalero Apache. The Court consistently finds in such cases that the tribal and federal interests outweigh the general interests of the state in generating revenue. This consistency supports the proposed Regulation that exempts from state taxation tangible personal property made from raw materials produced on the reservation.

The smoke shop cases generally follow an incidence analysis and then once the incidence is identified to fall on a non-Indian, a court can balance the federal, tribal and state interests to determine if the state tax is applicable. In Chemehuevi, the Supreme Court reviewed a decision by the 9th Circuit concluding that the legal incidence of the cigarette tax was on the tribe, and was therefore an illegal tax. The Supreme Court reversed that decision and held that the incidence was on the purchaser and that the state has the right to require the tribe to collect the tax for sales to non-Indians. On remand, the Court of Appeals reviewed the Chemehuevi decision and held that imposition of the state cigarette tax on sales to non-Indians on the reservation did not impermissibly interfere with the ability of the tribe to govern itself and did not burden and discriminate against Indian commerce. Chemehuevi Indian Tribe v. Board of Equalization, 800 F. 2d 1446. In applying a balancing test, the court found the state interest was significant when sales were made to non-Indians. The court considered it impermissible to market an exemption from the state sales tax in order to have a higher number of on-reservation sales.

It is clear the "smoke shop" cases are inapposite to the proposed regulation because the cases address the sale of products which are readily available outside of the reservation and have nothing unique about them which distinguishes them to the reservation. Washington v. Confederated Tribes of the Colville Indian Reservation, 447 U.S. 134, 100 S.Ct. 2069 (1980), and Moe v. Salish & Kootenai Tribes, 425 U.S. 463, 96 S.Ct. 1634 (1976). Similarly, in Salt River Pima-Maricopa Indian Community v. State of Arizona, 50 F.3d 734 (9th Cir. 1995), the Court found that the state could tax retail sales at a shopping mall on the reservation because "[t]he mall earns its profits simply by importing non-Indian products onto the reservation for resale to non-Indians." Id. at 738..

When the Indian Tribe or Retailer is marketing something not readily available off the reservation, it is by definition something unique. The case law concerning state taxation on reservations supports the conclusion that any such tangible property which is unique to the reservation because it is not readily available elsewhere is exempted from state tax because the tribal interests are heightened regarding anything unique to the reservation. The Supreme Court decisions in both Cabazon and Mescalero Apache indicate that where the item or thing is not generally available outside the reservation, the Court consistently finds that the tribal and federal interests outweigh the general interests of the state in generating revenue.

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October 3, 2002

Charlotte Paliani
Program Planning Manager
Sales and Use Tax Department
State Board of Equalization
450 N Street
Sacramento, CA 94279-0092

Dear Ms. Paliani:

On behalf of our clients the National Association of Convenience Stores ("NACS") and the Society of Independent Gasoline Marketers of America ("SIGMA") we are submitting comments regarding the *Discussion Paper on Regulation 1616, Federal Areas.*

NACS is an international trade association representing 2,000 convenience store companies. There are over 124,000 convenience stores in the United States. This industry employs nearly 1.4 million Americans and is built upon the small, family-owned convenience store. In fact, nearly 70 percent of NACS' members are small businesses operating 10 or fewer stores. NACS members sell their customers a variety of products including motor fuels and tobacco products.

SIGMA is an association of over 260 independent gasoline marketers operating in all 50 states. Last year, SIGMA members sold over 39 billion gallons of motor fuel, representing over 25 percent of all motor fuels sold in the United States in 1998. SIGMA members supply over 25,000 retail outlets across the nation and employ over 220,000 workers nationwide. Over half of SIGMA's members are classified as small businesses by the Small Business Administration and supply fewer than 40 retail motor fuels outlets with gasoline and diesel fuel. A fourth of S1GMA's members supply fewer than 20 outlets. SIGMA members also operate retail outlets (including travel plazas, traditional 'gas stations,' convenience stores with gas pumps, cardlocks and unattended public fueling locations) that sell a variety of products including tobacco.

We appreciate the opportunity to comment on the *Discussion Paper* because of the effect the issues it raises may have on California businesses. The California taxes collected and remitted (or not collected and remitted) by Native American tribes and tribal businesses can directly affect the convenience store and petroleum marketing industry. The United States Supreme Court has consistently held that states may require Native American tribes and enrolled members of those tribes operating businesses on the reservation to collect and remit to states sales, excise and use taxes properly imposed on non-Native Americans making purchases on the reservation. Native American tribes and enrolled members of those tribes making purchases on

their reservations are, however, exempt from state sales, excise and use taxes. In some cases, tribes and tribal retailers are expanding this special tax exemption by refusing to fulfill their obligations to collect state taxes when they transact business with non-Native Americans. These abuses injure retailers as well as local and state governments. In fact, many convenience stores have been put out of business because of these tax abuses.

Unfortunately, it appears that the Board of Equalization's *Discussion Paper* raises proposals that may exacerbate the problems created by the refusal of some tribes and tribal retailers to collect and remit legally imposed state taxes. If the Board of Equalization's regulations were modified consistent with the *Discussion Paper,* it would create a loophole in California's tax law excusing use taxes on sales of tangible personal property to non-Native Americans. This loophole is not legally necessary and is not good policy. While the *Discussion Paper* notes that there are exceptions to the ability of states to impose taxes on sales to non-Native Americans where the transactions have sufficient "reservation-based value," none of the cited cases reaches this result in the context of sales of tangible personal property. The only cases finding sufficient reservation-based value to pre-empt the imposition of state taxes involved hunting, fishing and off-track betting. *See New Mexico v. Mescalero Apache Tribe,* 462 U.S. 324 (1983); *Cabazon Band Mission Indians v. Wilson,* 37 F.3d 430 (9th Cir. 1994). By comparison, courts have specifically and repeatedly upheld requirements that tribes and tribal businesses collect and remit state taxes on sales of food and beverages to non-Native Americans. *See Yavapai-Prescott Indian Tribe v. Scott,* 117 F.3d 1107 (9th Cir. 1997); *Gila River Indian Community v Waddell,* 91 F.3d 1232 (9th Cir. 1996); *Salt River Pima-Maricopa Indian Community v. Arizona, 50 F.3d 734 (9th Cir. 1995); Gila River Indian Community v. Waddell,* 967 F.2d 1404 (9th Cir. 1992). In short, states may require tribes and tribal retailers to collect and remit use taxes on the sale of tangible personal property to non-Native Americans on the reservation without any exceptions.

It is NACS' and SIGMA's position that, particularly in light of the refusal by Native American tribes and tribal businesses around the country to collect and remit legally imposed taxes, state tax exceptions for Native American businesses should be no broader than legally required. Consistent with current law, then, NACS and SIGMA urge the Board of Equalization to reject any proposal to create exceptions to the requirement to collect and remit taxes on the sale of tangible personal property to non-Native Americans on reservations. We understand that this *position* is consistent with the current language of the regulation and that Board staff has recommended that the current regulation remain unchanged. NACS and SIGMA believe that the staff recommendation should be followed. Opening any loophole will only invite tax avoidance and abuses.

If the Board decides to include a provision allowing for a circumstance in which the reservation-based value of tangible personal property may be such that a sale to a non-Native American on the reservation will not be subject to the state use tax, then that exception should be drawn as narrowly as possible. Such a narrow exception should only be made for personal property that is completely manufactured on the Indian retailer's reservation. This is the only conceivable situation where "reservation-based value" might even arguably pre-empt the imposition of a state use tax on the sale of tangible personal property. We note, however, that the Board has not identified any court decision supporting such an exception in the *Discussion*

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Paper. A decision by thc Board of Equalization to impose an exception broader than this narrow formulation would abdicate the Board's public mission by failing to collect taxes that should fairly and legally be collected, and it would violate the Board's goal of interpreting and applying the tax laws correctly and fairly.

Should the Board of Equalization adopt any exception to state use taxes based on the "reservation-based value" of tangible personal property, we urge that the Board include protections to curtail potential abuses of the exception. These protections should include strict limits on the volume of tax-exempt product purchases by consumers in order to limit the opportunity for consumers to buy those products tax-free and re-sell them outside the reservation. Re-sale of goods bought on reservations to avoid tax payments can be damaging to small businesses and can be a drain on state revenues.

We also recommend that the Board change the definition of "Indian" that is included in the *Discussion Paper*. The proposed definition of "Indian" includes not only Indian tribes but "tribal organizations." It is unclear what a "tribal organization" is. Could this include any organization under tribal authority even if it is owned or run (in whole or in part) by non-Native Americans? We would recommend that the term "tribal organizations" be removed from the definition in order to clear up this potential ambiguity.

Sincerely,

Douglas S. Kantor